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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1941

No. 283

BUTLER BROTHERS, APPELLANT,

vs.

CHARLES J. McCOLGAN, AS FRANCHISE TAX COMMISSIONER OF THE STATE OF CALIFORNIA

APPEAL FROM THE SUPREME COURT OF THE STATE OF CALIFORNIA

FILED JULY 19, 1941.

SUPREME COURT OF THE UNITED STATES

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IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA, IN AND FOR THE CITY AND COUNTY OF SAN FRANCISCO

No. 277004

BUTLER BROTHERS, a Corporation, Plaintiff,

vs.

CHARLES G. JOHNSON, as Treasurer of the State of California, Defendant

COMPLAINT—Filed October 18, 1937

Plaintiff complains of defendant and for cause of action alleges:

I

Plaintiff is now and at all times herein mentioned has been a corporation organized and existing under and by virtue of the laws of the State of Illinois and qualified to conduct business in the State of California.

II

Defendant is now and at all times herein mentioned has been the duly elected, qualified and acting Treasurer of the State of California.

[fol. 5]

III

Pursuant to the provisions of the Bank and Corporation Franchise Tax Act, plaintiff, within the time provided by said Act, filed its return for the calendar year 1935 showing that for said year plaintiff derived no net income from business done within the State of California. At the time of filing said return plaintiff paid the minimum tax of Twenty-five Dollars ($25.00) provided by law. Subsequently, on January 25, 1937, the Franchise Tax Commissioner of the State of California gave notice to plaintiff of a proposed assessment of an additional tax of Three Thou-

sand Seven Hundred Ninety-eight and 43/100ths Dollars ($3,798.43). Thereafter, and within sixty days after the mailing of said notice, the plaintiff filed with said Commissioner a written protest under oath, protesting the levy of the proposed additional tax and specifying the grounds upon which such protest was based. A copy of said profest is hereto attached, marked Exhibit "A" and made a part hereof. Thereafter, and on August 5, 1937, said Commissioner mailed written notice to plaintiff that he had affirmed such proposed additional assessment, and on September 8, 1937, said Commissioner assessed such additional tax in the amount of Three Thousand Seven Hundred Ninety-eight and 43/100ths Dollars ($3,798.43), with interest thereon from March 15, 1936. Thereafter, and on September 16, [fol. 6] 1937, plaintiff paid to defendant, as Treasurer of the State of California, said sum of Three Thousand Seven Hundred Ninety-eight and 43/100ths Dollars ($3,798.43), together with interest thereon in the amount of Three Hundred Forty-four and 67/100ths Dollars ($344.67). Said payment was made under protest, which protest was in writing and under oath, and stated the grounds upon which plaintiffs claimed that said additional tax and all thereof is and was void. A copy of said protest is hereto attached, marked Exhibit "B" and made a part hereof.

IV

Said additional assessment and all thereof was and is void for each and all of the reasons and grounds set forth in said protest (Exhibit "B" hereto), to which reference is hereby made, and the same is incorporated herein as if herein set forth at length.

Wherefore, plaintiff prays judgment against defendant for the sum of Four Thousand One Hundred Forty-three and 10/100ths Dollars ($4,143.10) so paid as aforesaid and for interest thereon as provided by law from the date of payment, and for such other and further relief as may be meet and proper in the premises.

Brobeck, Phleger & Harrison, Attorneys for Plaintiff.

[fol. 7] *Duly sworn to by F. S. Cunningham. Jurat omitted in printing.*

[fol. 8] EXHIBIT "A" TO COMPLAINT

Protest of Butler Brothers to Proposed Additional Franchise Assessment for Taxable Year ended December 31, 1936

Charles J. McColgon, Franchise Tax Commissioner, Sacramento, California.

Re No. 8350

DEAR SIR:

Protest is herewith made to your proposed additional franchise tax assessment amounting to $3,798.43.

The proposed additional assessment is based upon the theory that the general net income of the undersigned from the whole of its business transacted in the United States should be allocated to the State of California upon the basis as set forth in Schedule J. of the return.

There was attached to the return a statement calling attention to the fact that the actual operations of the San Francisco branch house had resulted in an actual loss of $82,851 for the calendar year 1935, which statement was supported by a schedule attached showing the result of such operations. It is not understood that the figures there given are in any way disputed.

The question, therefore, is as to whether the statutory method of allocation should be given effect as against the actuality of the case.

[fol. 9] Any method of allocation of the kind set forth in Schedule J is to a large extent arbitrary and is intended, and can be sustained, only as a means for arriving at net income attributable to the business carried on in the State of California. If such a method of allocation, or if any statutory or arbitrary method of allocation, works out in actual practice with a reasonable approximation of income attributable to California the method will be sustained. If, however, such method does not so work out, and results, in practical effect, in attributing to the State of California an unreasonable amount of income as compared to the business of the company done in its entirety and in other jurisdictions, or creates in California an income non-existent in fact, the statutory method of allocation must give way, and will not be sustained.

The undersigned respectfully insists that inasmuch as the actual results of the operation of its business in the State of California is a loss the statutory method of allocation is inapplicable, and that therefore it is subject only to a minimum tax.

It is conceived that the position here taken is supported by *Hans Rees' Sons, Incorporated v. North Carolina*, 283 U. S. 123.

Undersigned again states and insists, as it stated and insisted in its return as filed, that to impose a tax based upon the method of allocation set forth in Schedule J of the [fol. 10] return is a violation of the undersigned's rights under both the California and United States Consfitutions. An oral hearing is requested.

Respectfully submitted, Butler Brothers, by Frank J. Kearns, Treasurer.

STATE OF ILLINOIS,
County of Cook, ss.:

FRANK J. KEARNS being first duly sworn upon oath deposes and says that he is Treasurer of Butler Brothers, the corporation whose name is subscribed to the foregoing protest; that he is familiar with the matters contained in said protest and that the same are true both in substance and in fact; and that as Treasurer he subscribed the name of said corporation to said protest and his own name as treasurer of said corporation.

Frank J. Kearns.

Subscribed and sworn to before me this 20th day of March, A. D. 1937. A. F. Bodenstab, Notary Public. (Seal.)

[fol. 11] EXHIBIT "B" TO COMPLAINT

Chicago, Illinois, September 10, 1937.

Hon. Chas. J. McColgan, Franchise Tax Commissioner, Sacramento, California and Hon. Charles G. Johnson, State Treasurer, Sacramento, California.

GENTLEMEN:

There is paid herewith the sum of $4,143.10, being the additional tax imposed for the taxable year ended December

31, 1936 on the undersigned under the Bank and Corporation Franchise Tax Act, as set forth in "Notice of additional franchise tax proposed to be assessed", dated January 25, 1937, and in "Notice of action of Franchise Tax Commissioner upon taxpayer's protest", dated August 5, 1937, in the amount of $3798.43, and interest thereon from March 15, 1936 in the amount of $344.67. Said sum and all thereof is paid under protest, the grounds of said protest being:

Butler Brothers is a corporation organized and existing under the laws of Illinois, doing business in the State of California. Its principal place of business is in the City of Chicago, County of Cook, and State of Illinois. It maintains and operates seven distributing or branch houses in the following localities: Chicago, Illinois; Minneapolis, Min-
[fol. 12] nesota; St. Louis, Missouri; Jersey City, New Jersey (which includes sales offices and sample rooms in New York City); Baltimore, Maryland; Dallas, Texas, and San Francisco, California. The business of the company is the wholesaling of general merchandise. It maintains at its San Francisco house a stock of merchandise from which orders received and accepted at San Francisco are filled. It also maintains in the City of Los Angeles a sales and sample room. Stocks of merchandise are also maintained at the above-mentioned distributing houses, out of which orders are filled in the territory tributary to said respective houses. All of the sales made by Butler Brothers in California and territory tributary to the San Francisco house are made through the San Francisco house (including the Los Angeles sales and sample room), and the San Francisco house, together with said Los Angeles sales and sample room, is the only part of its business conducted within the State of California.

Separate accounts are kept of the operation of each branch of the establishment of Butler Brothers, including the San Francisco branch. All merchandise sold therein is charged at actual cost and other expenses of conducting said business are directly apportioned to said San Francisco branch, so that the exact income and expenses thereof can be ascertained. During the calendar year 1935, said San Francisco
[fol. 13] branch operated at a loss of $82,851.00 and the minimum tax under the Bank and Corporation Franchise Tax Act, to wit: $25.00, was paid by said Butler Brothers on or about March 15, 1937.

The additional assessment, payment of which is herewith protested, is predicated upon the allocation to California of income of Butler Brothers derived solely from operation of its business in states other than in California, and no part of the net income of Butler Brothers is derived from business done within the State of California.

The allocation to California of income derived from business done without the State of California does not fairly or at all assign to the State of California the net income of Butler Brothers reasonably attributable to the business done within this state and subjects Butler Brothers to double taxation.

The method of allocation followed by the Franchise Tax Commissioner is arbitrary and unreasonable and does not fairly or at all allocate to California the net income derived from business done within the State of California. To the contrary, the same purports to allocate to California income derived wholly from business done without the State of California. In fact, no net income has been derived from business done within the State of California.

The tax assessed upon Butler Brothers by the Franchise Tax Commissioner is a tax upon business and transactions [fol. 14] conducted without the State of California, is without the power of jurisdiction of the State of California, will deprive Butler Brothers of property without due process of law, will deprive Butler Brothers of the equal protection of the law, and is in violation of its rights under the Constitution of the United States and the Constitution of the State of California.

The Bank and Corporation Franchise Tax Act, if construed as authorizing the assessement of the taxes here protested, is in violation of the Constitution of the United States and of the Constitution of the State of California.

Respectfully submitted, Butler Brothers. (Signed)
D. R. Treat, Comptroller.

State of Illinois,
County of Cook, ss.:

D. R. Treat, being the first duly sworn upon oath deposes and says:

That he is Comptroller of Butler Brothers, the corporation whose name is subscribed to the foregoing protest; that

he is familiar with the matters contained in said protest and that the same are true both in substance and in fact; and that as Comptroller he subscribed the name of said corporation [fol. 15] to said protest and his own name as Comptroller of said corporation.

(Signed) D. R. Treat.

Subscribed and sworn to before me this 10th day of September, 1937. (Signed) A. F. Bodenstab, Notary Public in and for the County of Cook, State of Illinois. (Seal)

[File endorsement omitted.]

In Superior Court for City and County of San Francisco

Answer—Filed November 27, 1937

Comes now the defendant above named, Charles G. Johnson, as Treasurer of the State of California, and answering the complaint on file herein admits and denies as follows, to-wit:

I

Defendant admits the allegations of the complaint on file herein except as hereinafter qualified.

II

Defendant denies all and singular, each and every, specifically and generally the allegations found in paragraph IV of the complaint on file herein, and further denies the allegations found in the protest which is incorporated in paragraph IV of the complaint on file herein.

[fol. 16] Wherefore, defendant prays that plaintiff take nothing by its action herein, and for costs of suit incurred herein.

U. S. Webb, Attorney General, H. H. Linney, Deputy, James J. Arditto, Deputy, Attorneys for Defendant.

[File endorsement omitted.]

IN SUPERIOR COURT FOR CITY AND COUNTY OF SAN FRANCISCO

STIPULATION AS TO CERTAIN FACTS—Filed July 21, 1938

It is hereby stipulated that the following facts, in addition to the facts alleged in the complaint admitted by defendant's answer herein, shall be deemed to have been proven by competent evidence:

1. Butler Brothers, plaintiff herein (hereinafter called the Company), is a corporation organized under the laws of Illinois and is qualified to conduct business in California. Its corporate principal place of business is in Chicago, Illinois. The Company is engaged in the wholesale dry goods and general merchandise business, purchasing from manufacturers and others, and selling such commodities to retailers only. It maintains and operates wholesale distributing houses at Chicago, Illinois, Minneapolis, Minnesota, St. Louis, Missouri, Jersey City, New Jersey, Baltimore, Maryland, Dal- [fol. 17] las, Texas, and San Francisco, California. The San Francisco house was opened by the Company in 1928, being the last established of all the Company's houses, except that the one at Baltimore was acquired as a going concern in 1930.

2. Stocks of goods are maintained at each of the Company's houses hereinabove mentioned, from which sales in the respective territories served by each house are made. Each house serves a separate trade territory, having its own sales force, and all sales made by the Company in the State of California are made from the San Francisco house. Each house handles its own sales and all solicitation, credit and collection arrangements in connection therewith. Books of account are kept at each house, wherein are entered the sales made thereat, the amounts paid for goods sold therefrom, transportation charges and other operating expenses, including the allocation of certain common expenses referred to in paragraph 4 hereof. It is agreed that all receipts from sales made in California have been credited to the San Francisco house.

3. The Company maintains a central buying division through which goods for resale are ordered, but such goods are shipped by the manufacturers to the houses for which ordered, where the cost thereof and transportation charges thereon are entered on the books of the house. No charges

are made against any house for the benefit of the Company [fol. 18] or any other house by reason of such centralized purchasing, but the actual cost of operating the centralized buying division is allocated to the houses, as stated in paragraph 4 hereof. The greater part of other operating expenses incurred by the Company are directly and exclusively incurred at the respective houses, including such items as labor, rentals and similar expenses.

4. There are certain items of expense which are incurred and paid by the Company for the benefit of all houses, the costs of which are allocated to the respective houses. No question exists as to the accuracy of the amounts of such expense or to the method of allocation employed, which is in accordance with recognized accounting practices. For the year 1935 the amount of such allocated expense charged to the San Francisco house was $100,091. For the purposes of this case, and without prejudice to the claims of either party in any subsequent year, it is agreed that approximately 75% of the $100,091 overhead expense so allocated would have been incurred even though the San Francisco house was not operated, and that the accuracy and propriety of the basis of allocation of such common expenses for the year 1935 are admitted. Included in such expenses are executive salaries, certain accounting expenses, the cost of operating a central buying division, and a central advertising division. Except for such common expenses, each house is operated independently of each other house.

[fol. 19] 5. The Company computed its income from the operation of the San Francisco house by deducting from the gross receipts from sales of merchandise in California, determined as indicated in paragraph 2 above, the costs of such merchandise, determined as indicated in paragraph 3 above, the direct expenses of the San Francisco house referred to in paragraph 3, and the indirect expense allocated to the San Francisco house in the manner described in paragraph 4 above. According to this computation, the San Francisco house operated at a loss of $82,851 during the year 1935.

6. The Company filed with the Franchise Tax Commissioner a report in the prescribed form, wherein it was reported that the San Francisco house was operated at said loss and, within the time provided by law, paid the mini-

mum tax of $25 for the year 1936. An additional assessment was made by the Franchise Tax Commissioner and paid by the Company as alleged in the complaint.

7. In the year 1935 the operations of all houses of the Company produced a profit of $1,149,677. The additional tax assessed by the Franchise Tax Commissioner was predicated on the allocation to California of 8.1372% of the total income of the Company derived from all sources, such percentage having been determined by mathematical average of the percentages which (a) value of real and tangible personal property, (b) wages, salaries, commissions and other [fol. 20] compensation of employees, and (c) gross sales, less returns and allowances, attributable to the San Francisco house bore to the corresponding items of all houses of the Company. It is also agreed that the Franchise Tax Commissioner, in imposing the additional assessment upon the Company, did not give consideration to any other factor or method of allocation. No question exists as to the accuracy of the Commission's calculation, nor respecting the use of the above formulas, if, by reason of the facts stipulated herein, a formula for allocation to California of a portion of the Company's income from all sources is proper. This stipulation is made without prejudice as to any other year than that on which the tax here involved is predicated.

8. In the year 1935 the total sales made by the Company at all houses amounted to $66,326,000, of which $5,206,000 were made from the San Francisco house. The purchases made for the account of the San Francisco house were substantially in the same proportion to total purchases. All purchases made by the Company for sale at its various houses are made through a central buying division. By reason of the volume of purchases made by the Company more favorable prices are obtained than would be obtainable in respect of purchases for the account of any individual house operated by the Company.

[fol. 21] 9. The addition of purchases in an amount equal to the purchases made for the account of the San Francisco house results in no more favorable prices than could be obtainable in respect of purchases in an amount equal to the purchases which would be made by the Company for its other houses if the San Francisco house were not in existence, and a reduction in the volume of purchases in an

amount equal to the purchases made for the San Francisco house would result in no less favorable prices being obtainable in respect of the purchases which would be made for the remaining houses of the Company. The stipulation in this paragraph shall not be deemed an admission by defendant that plaintiff is entitled to segregate the income of its San Francisco house from that of other houses for purposes of computing franchise tax.

10. It is claimed by defendant that by reason of the facts hereinabove set forth the operations of the Company are unitary in character and that the formula for allocation of income used by the Franchise Commissioner was lawful and proper and that the Company is not entitled, for the purpose of determining tax payable under the Bank and Corporation Franchise Tax Act, to use separate accounting of its San Francisco house to determine its net income in the State of California.

11. It is claimed by the Company that its operations are not unitary in character; that its net income reasonably [fol. 22] attributable to the business done within the State of California is the income derived from its San Francisco house alone which resulted in a loss in the year 1935; that the method of allocation used by the Commissioner is not in accordance with the provisions of the Bank and Corporation Franchise Tax Act, and that if said Act is construed as authorizing such method of allocation and assessment, said Act is in violation of the due process clause of the Fourteenth Amendment to the Constitution of the United States.

12. It is agreed that the foregoing facts, in addition to those alleged in the complaint and admitted by the answer, were submitted to and considered by the Franchise Tax Commissioner, and that the assessment of additional tax made by him was predicated entirely upon the theory that as a matter of law the business done by the Company as hereinbefore set forth is a part of a unitary business warranting the application of the method of allocation of the Company's total net income hereinabove described. It is agreed that no other fact or circumstance was considered or used by the Commissioner in making such assessment and that the Court, in determining this case, shall be bound by no inference or presumption in respect of any matter

of fact not herein set forth, and if, despite this stipulation, the Court deems that it is found by any inference or presumption respecting the assessment made by the Commis-
[fol. 23] sioner, or that this stipulation fails to establish any fact necessary to a decision, the case shall be re-opened for the taking of further proofs in respect thereof.

13. The stipulations of fact herein contained are without prejudice to the claim of plaintiff that its earnings in California are solely those derived from operation of its San Francisco house, and that it is taxable in California only in respect of such earnings, without regard to earnings from its operations in other states and without prejudice to the claim of defendant that plaintiff's operations in California are of such a character as to be incapable of segregation from its other operations, and that plaintiff may be taxed on an allocation of its entire net income in the manner done by the defendant.

Dated July 8, 1938.

U. S. Webb, Attorney General, H. H. Linney, Deputy Attorney General, By James J. Arditto, Deputy Attorney General, Attorneys for Defendant. Brobeck, Phleger & Harrison, Attorneys for Plaintiff.

[File endorsement omitted.]

[fol. 24] In Superior Court for City and County of San Francisco

Findings of Fact and Conclusions of Law—Filed October 10, 1938

This cause came on regularly for trial on the 21st day of July, 1938, before the Court sitting without a jury, no jury having been demanded by either party, Messrs. Brobeck, Phleger & Harrison appearing as attorneys for plaintiff, and Messrs. U. S. Webb, H. H. Linney and James J. Arditto appearing as attorneys for defendant; stipulation of facts, signed by counsel for the respective parties was filed and received by the Court, and the cause thereafter argued and submitted;

The Court having considered the evidence and the arguments of the parties, and being fully advised in the premises, now makes its Findings of fact and Conclusions of Law as follows:

FINDINGS OF FACT

1. The Court finds that the facts are as stated in the stipulation of facts on file herein, and said stipulation of facts is hereby adopted as the Findings of Fact of the Court.

And as

CONCLUSIONS OF LAW

therefrom, the Court decides:

1. That the assessment of additional tax made by the Franchise Tax Commissioner of the State of California in [fol. 25] the amount of Three Thousand Seven Hundred Ninety-eight and 43/100ths Dollars ($3,798.43) was duly and regularly made pursuant to the Bank and Corporation Franchise Tax Act;

2. That plaintiffs take nothing by this action.

Let judgment be entered accordingly.
Done in open Court this 7 day of October, 1938.

J. J. Trabucco, Judge of the Superior Court.

[File endorsement omitted.]

IN SUPERIOR COURT FOR CITY AND COUNTY OF SAN FRANCISCO

JUDGMENT—Filed October 10, 1938

This cause came on regularly for trial on the 21st day of July, 1938, before the Court sitting without a jury, no jury having been demanded by either party, Messrs. Brobeck, Phleger & Harrison appearing as attorneys for plaintiff, and Messrs. U. S. Webb, H. H. Linney and James J. Arditto appearing as attorneys for defendant, and a stipulation of facts, signed by the parties, having been filed herein and received by the Court, and the cause thereafter argued and submitted, and the Court having made and signed its Findings of Fact and Conclusions of Law herein and or-

[fol. 26] dered that judgment be entered in accordance therewith;

Now, Therefore, It is Ordered, Adjudged and Decreed that plaintiff Butler Brothers, a corporation, take nothing by its action herein, and that defendant do have and recover from plaintiff his costs herein incurred in the sum of $—.

Done in open Court this 7th day of October, 1938.

J. J. Trabucco, Judge of the Superior Court.

Recorded October 11, 1938, Vol. 445, page 290, Oct. 11, 1938. H. A. van der Zee, Clerk, by C. E. Coghlan, Deputy Clerk.

[File endorsement omitted.]

[fol. 27] Clerk's certificate to judgment roll omitted in printing.

[fol. 28] IN SUPERIOR COURT FOR CITY AND COUNTY OF SAN FRANCISCO

NOTICE OF APPEAL—Filed October 15, 1938

To the clerk of the above-entitled court and to Charles G. Johnson, as Treasurer of the State of California, the defendant herein, and to Messrs. U. S. Webb, H. H. Linney and James J. Arditto, attorneys for said defendant;

You will please take notice that the plaintiff in the above-entitled action hereby appeals to the Supreme Court of the State of California from the judgment entered therein in the said Superior Court on the 11th day of October, 1938, wherein judgment was entered in favor of the defendant and against plaintiff and from the whole thereof.

Dated San Francisco, California, October 14, 1938.

Brobeck, Phleger & Harrison, Attorneys for Plaintiff.

Receipt of a copy of the within Notice of Appeal is hereby admitted this 15th day of October, 1938.

U. S. Webb, Atty. Gen., by James J. Arditto, Deputy.

[File endorsement omitted.]

[fol. 29] IN SUPERIOR COURT FOR CITY AND COUNTY OF SAN FRANCISCO

STIPULATION AS TO TRANSCRIPT ON APPEAL

It is hereby stipulated that the foregoing transcript on appeal is correct; that it contains full, true and correct copies of all the papers therein set forth now on file in the office of the county clerk of the City and County of San Francisco, State of California; that the said foregoing papers shall constitute the transcript on appeal in this cause and that the appeal may be heard and determined thereon.

Dated October 27, 1938.

Brobeck, Phleger & Harrison, Attorneys for Appellant. U. S. Webb, H. H. Linney, Attorneys for Respondent.

[fols. 30-33] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 34] IN SUPREME COURT OF CALIFORNIA

S. F. No. 16157

3 Civ. 6464

BUTLER BROTHERS, a Corporation, Plaintiff and Appellant,

vs.

CHARLES G. JOHNSON, as State Treasurer of the State of California, Defendant and Respondent

MOTION AND ORDER SUBSTITUTING PARTY DEFENDANT—Filed April 22, 1940

Come now Brobeck, Phleger & Harrison, attorneys for plaintiff, and request that pursuant to section 30 of the Bank and Corporation Franchise Tax Act "Charles J. McColgan as Franchise Tax Commissioner of the State of California" be substituted as defendant herein in the place and stead of Charles G. Johnson, as State Treasurer of the State of California.

Dated this 12 day of April, 1940.

Brobeck, Phleger & Harrison, Attorneys for Plaintiff.

Counsel for defendant hereby consent that the order of substitute*d* be made.

Earl Warren, Attorney General; H. H. Linney, Deputy; Valentine Brookes, Deputy.

By the Court:

In the above entitled action, upon motion of the plaintiff, the Attorney General consenting thereto, it is hereby ordered that "Charles J. McColgan, as Franchise Tax Commissioner of the State of California" be and he is hereby substituted as defendant herein in the place and stead of "Charles G. Johnson, State Treasurer of the State of California."

Apr. 22, 1940.

Thompson, Acting P. J.

[File endorsement omitted.]

[fol. 35] In District Court of Appeal of California

San Francisco—J. J. Trabucco, Judge

Civil No. 6464. Third Appellate District

May 18, 1940

101 C. A. D. 612

Butler Brothers (a Corporation), Plaintiff and Appellant,

v.

Charles J. McColgan, as Franchise Tax Commissioner of the State of California, in the Place and Stead of Charles G. Johnson, State Treasurer of the State of California, Defendant and Respondent

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Opinion and Judgment

This action was brought to recover the sum of $4,143.10, being the amount of taxes and interest thereon paid to respondent under protest. Judgment was entered in favor of respondent, and plaintiff appealed therefrom.

The cause was submitted upon an agreed statement of facts which may be summarized as follows:

Plaintiff and appellant, Butler Brothers (herein called "the Company"), is an Illinois corporation, having its principal corporate office at Chicago. It is engaged in the wholesale dry goods and general merchandise business, purchasing from manufacturers and others, and selling to retailers only. It operates seven distinct wholesale houses at Chicago, Jersey City, Baltimore, Minneapolis, St. Louis, Dallas and San Francisco. Each of these houses serves a separate trade territory. At each house stocks of goods are maintained, from which sales are made in its territory. Each handles its own sales, and all solicitation, credit and [fol. 36] collection arrangements in connection therewith, and keeps books of account showing the operations of the house. All sales in California were made from the San Francisco house and all receipts credited thereto.

The greater part of the operating expense of the houses is directly and exclusively incurred at the respective houses, including such items as labor, rentals, etc. There are, however, some common expenses such as executive salaries and corporate overhead and the expense of operating a central buying division and a central advertising division. These expenses are apportioned to the respective houses on bases which, it is agreed, are in accord with recognized accounting practice, and the accuracy and propriety of such bases of apportionment are here conceded. The aggregate of such common expenses so charged to the San Francisco house for the year 1935 was $100,091, of which, it is agreed, approximately 75 per cent would have been incurred whether or not the San Francisco house were operated. Except for such common expenses, each house is operated independently of each other house.

Through a central buying agency goods required for resale in the various houses are ordered, but such goods are shipped directly from the manufacturer to the houses, where the cost thereof, with transportation charges thereon, is entered on the books of the house. No charges are made against any house for the benefit of the company, or any other house by reason of such centralized purchases, but the actual cost of operating the central buying division [fol. 37] is allocated to the houses as stated in the preceding paragraph. By reason of the volume of purchases so

made, more favorable prices are obtained than would be obtainable in respect to purchases for the account of any individual house, but addition or subtraction of purchases in the volume made for the San Francisco house would have no effect on the prices obtainable for the remaining houses.

The accounts of the San Francisco house, computed by deducting from the gross receipts from all sales made therefrom (which includes all sales made and business done in California) the actual cost of merchandise and other direct expenses, and the apportioned share of common expenses previously described, showed for the year 1935 a loss of $82,851. Within the time allowed by law a report showing this loss was made and the minimum tax of $25 was paid for the year 1936. During the year 1935 the operations of all houses of the company produced a profit of $1,149,677. The commissioner subsequently assessed an additional tax of $3,798.43; which, with interest amounting to $344.67, was paid under protest on September 16, 1938. The additional assessment was predicated on the allocation to California of 8.1372 per cent of the company's total income derived from all sources. This percentage was a mathematical average of the percentages which the value of the tangible property, payroll and gross sales attributable to California bore [fol. 38] to the corresponding items of all houses of the company. If an allocation is proper, use of the particular percentage here used is not questioned.

The tax in question was levied under the provisions of section 10 of the Bank and Corporation Franchise Tax Act (General Laws, Act 8488, vol. 2, p. 3851). That section provides:

"If the entire business of the bank or corporation is done within this state, the tax shall be according to, or measured by its entire net income; and if the entire business of such bank or corporation is not done within this state, the tax shall be according to, or measured by that portion thereof which is derived from business done within this state. The portion of net income derived from business done within this state, shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the state the portion of net income reasonably attributable to the business done within this state and to avoid subjecting the taxpayer to double taxation * * *."

It is contended by appellant that the method by which the tax was fixed and computed was unauthorized and unlawful, and that such method had the effect of taxing plaintiff on, and in respect to income derived from sources be- [fol. 39] yond the jurisdiction of the state. This resulted, it is contended, in a denial of due process of law, and of the equal protection of the law, in violation of the Fourteenth Amendment of the Constitution of the United States.

On the other hand, respondent contends that the tax was levied upon income from business derived from within this state; that such business was unitary in character; and that the state was therefore justified in applying the formula method in arriving at the net income of appellant.

The sole question presented is whether the franchise commissioner should have adopted the separate accounting method in computing the franchise tax, or whether it was proper and legal for him to have used the formula system. If the first method is used, only the minimum tax of $25 would be due. Under the second method, which was actually applied here, the tax amounted to $3,798.43. The first method shows a loss in the California operations of appellant amounting to $82,851. Under the second, respondent showed that appellant enjoyed and received a net income from the business done in California amounting to $95,000. *In respect to net income, the two methods are some $177,851 apart.* Both methods are described in the stipulated facts above. The first is obviously based upon strict and accurate accounting procedure, while the second is the [fol. 40] application of a set formula which has been approved in many jurisdictions in those cases where interstate operations are carried on, and where, from the nature of such operations, income cannot be properly allocated by separate accounting methods. Plain instances which justify the application of the formula method would be telegraph, telephone, railroad and express companies. If there is any evidence to sustain a finding that the operations of appellant in California, during the year 1935, contributed to the net income derived from its entire operations in the United States, it would seem as though the method used was a proper one. Such income would be within the purview of the statute quoted above—"The portion of the net income derived from business done within this state". Where the formula method is adopted by the taxing power, the burden of proof is upon the taxpayer to show that such

method has been applied unreasonably and arbitrarily. (*Hans Rees' Sons* v. *State of North Carolina*, 283 U. S. 123.)

Appellant earnestly contends that the evidence is insufficient to justify the imposition of the formula. It points out that there is nothing in the stipulated facts which would justify a finding that it was doing a unitary business, and even if there were such evidence, the method used operated arbitrarily and unreasonably in respect to appellant's busi- [fol. 41] ness. It is agreed by all parties that the formula of allocation to California of a portion of appellant's income from all sources, is proper, if the facts of the case justify the application of a formula. The question is not whether the formula used is fair and proper, but whether, under the facts here, there should be any allocation at all.

The factual structure of the case is relatively simple. Appellant is engaged in buying merchandise from manufacturers and others, and selling to retailers only. It does no manufacturing. It maintains a central buying division, but goods are shipped directly from the manufacturer to the houses in the several states, where the cost thereof and transportation charges are entered upon the books of the house. Further facts appear in the summary given above.

It is fundamental that jurisdiction to tax is dependent upon jurisdiction of the person or transaction sought to be taxed and that for a state to tax property on transactions beyond its jurisdiction is a denial of due process of law and of the equal protection of the laws. (*Frick* v. *Pennsylvania*, 268 U. S. 473.) Where, however, property located in two or more states derives a value from its unity of use, allocation of the composite value on a fair and reasonable basis will be sustained. The familiar illustration of this principle is in the assessment of railroad [fol. 42] property. (*The Railroad Tax Cases*, 92 U. S. 575.) Referring to a unitary business, "That term is simply descriptive, and primarily means that the concern to which it is applied is carrying on one kind of business—a business, the component parts of which are too closely connected to each other to justify division of separate considerations, as independent units." (*Maxwell* v. *Kent-Coffey Mfg. Co.*, 204 N. C. 365, 168 S. E. 397.) It has further been held that unity of *use* is something more than mere unity of *ownership*. (*Adams Express Co.* v. *Ohio*, 165 U. S. 194-222.) The allocation may be made by the

application of a formula, which is based upon certain factors. The following excerpt from the stipulated facts describes the formula used and the manner of its application:

"In the year 1935, the operations of all houses of the Company produced a profit of $1,149,677. The additional tax assessed by the Franchise Tax Commissioner was predicated on the allocation to California of 8.1372% of the total income of the Company derived from all sources, such percentage having been determined by mathematical average of the percentages which (a) value of real and tangible personal property, (b) wages, salaries, commissions and other compensation of employees, and (c) gross sales, less returns and allowances, attributable to the San Francisco house bore to the corresponding items of all houses of the Company."

[fol. 43] The fact that a corporation does business in more than one state does not necessarily justify the application of a formula to ascertain the tax. In *Hans Rees' Sons* v. *State of North Carolina, supra,* the court held:

"But the fact that the corporate enterprise is a unitary one, in the sense that the ultimate gain is derived from the entire business, does not mean that for the purpose of taxation the activities which are conducted in different jurisdictions are to be regarded as 'component parts of a single unit' so that the entire net income may be taxed in one State regardless of the extent to which it may be derived from the conduct of the enterprise in another State."

Where, however, a business is unitary in character, that is, where its separate parts cannot be fairly considered by themselves, and where the whole business in the several states derives a value from the unity of use, allocation of income upon a reasonable formula has been sustained. (*Bass, Ratcliff & Gretton* v. *State Tax Commission,* 266 U. S. 271; *Underwood Typewriter Co.* v. *Chamberlain,* 254 U. S. 113.) Aside from the question as to the propriety of applying a formula here, and paramount over all other considerations, is the question whether or not it reasonably appears that a portion of the total net income of appellant was "derived from business done within this State". (Sec. 10 of Act 8488—fully quoted above.)

[fol. 44] The only factor called to our attention by respondent which might point to a unitary business is the

central buying power exercised by the headquarters of appellant in Illinois. The state argues that even though the California house lost money during the year 1935, the operations conducted during that year actually brought a profit to the corporation. They contend that the disposal of some $5,000,000 worth of merchandise during the time mentioned, increased the purchasing power of appellant, and thus permitted it to buy for its other houses, through volume purchases, at a price lower than it otherwise would have secured. It appears, however, that the parties have stipulated otherwise. We quote from the agreed facts: "A reduction in the volume of purchases made for the San Francisco house would result in no less favorable prices being obtainable in respect of the purchases which would be made for the remaining houses of the Company."

Most of the cases cited by respondent, with one exception, involve corporations which are engaged in *manufacturing*. In those instances a manufacturing profit was made by the corporation before the merchandise was shipped to another state. This is true of the Underwood case, supra. Here, none of the merchandise was manufactured by appellant. It was engaged solely in buying and selling. There are cases where a corporation engaged in buying and selling has been held subject to the payment of income taxes in [fol. 45] one of the states where it has been doing business. In *International Elevator Co.* v. *Thoresen*, 58 N. D. 776, 228 N. W. 192, a company which bought and sold grain was held liable for the payment of an income tax in the state of North Dakota. It bought grain in that state and shipped it for resale in other states. The corporation filed a return showing only income derived from sales in North Dakota. It failed to account for sales outside the state, and contended that only transactions within the state should be considered in fixing its income. It showed that it had lost some $85,000 on transactions *within the state*. Its net profit from all its operations in several states amounted to $249,515.11. A tax of $2,937.98, computed by a formula, was upheld. The case was clearly one where a separate accounting system did not disclose the income received from shipment and sale of grain outside the state. The return by the elevator company included only income received from sales at North Dakota elevators. The case of *Montgomery Ward & Co.* v. *Kansas Tax Commission*,

151 Kan. 159, 98 Pac. (2d) 143, throws little light upon the question. No attempt was there made by the state to base a tax upon the net income of the corporation outside the state of Kansas. The only question was whether or not the corporation was entitled to charge against its Kansas income a proportionate share of certain expenses in- [fol. 46] curred outside the state. The court held in the affirmative.

Appellant relies strongly upon the case of *Standard Oil Co.* v. *Wisconsin Tax Commission*, 223 N. W. 85. Wisconsin taxes corporations on a basis very similar to our Bank and Corporation Franchise Tax Act and provides for allocation of income in a manner very like section 10. A company engaged in the production, refining and sale of petroleum products but engaged only in selling within Wisconsin was taxed on the basis of a statutory allocation of income from the entire operation. In that case it was shown that accurate accounting of the operations of the various branches existed. The court there held:

"In the enactment of the statute relating to the allocation of income of persons doing business within and without the State, the declared legislative purpose is to make a reasonable and equitable distribution of the taxpayer's income to the end that that part of the income justly assessable in the State of Wisconsin may be ascertained. The statute does not enjoin upon the Commission the use of that method which will produce the largest amount of taxable income but rather that method which will most justly apportion the income properly taxable in Wisconsin. Here it appears conclusively that it is possible to ascertain the income derived from business transactions in Wisconsin by the application of proper accounting methods. • • • There [fols. 47-48] are some operations which from their very nature produce an income which cannot be properly allocated by separate accounting methods, instances of which are the telegraph, telephone and express companies. They stand ready to serve whoever may apply for service and the entire operation constitutes a unit of service. *That is not the case with the manufacturing and sales business, particularly so where the accounts are so kept as to be readily separable.*"

We regard the foregoing case as very persuasive authority to the effect that a separate accounting method should be applied in the instant case.

We therefore conclude that the stipulated facts show that the company actually incurred a loss in California; that its California earnings could have been accurately ascertained without the necessity of recourse to any arbitrary formula, and that the use of such formula results in the imposition of a tax on income not earned in California, and therefore not subject to its taxing power.

The facts found do not support the judgment, and it is ordered that the judgment be reversed, with directions to the trial court to enter judgment in favor of appellant.

Tuttle, J.

We concur:
Pullen, P. J.
Thompson, J.

[fol. 49] IN SUPREME COURT OF CALIFORNIA, IN BANK

S. F. No. 16157

BUTLER BROTHERS, a Corporation, Plaintiff and Appellant,

vs.

CHARLES J. McCOLGAN, As Franchise Tax Commissioner of the State of California, Defendant and Respondent

OPINION—Filed March 21, 1941

This action was brought to recover an additional assessment made by the defendant as Franchise Tax Commissioner under authority of the Bank and Corporation Franchise Tax Act (Statutes 1929, Ch. 13, as amended) for the taxable year 1936, based upon income for the year 1935, paid by plaintiff under protest. Judgment was entered in favor of defendant, and plaintiff appealed therefrom.

The cause was submitted upon an agreed statement of facts, which may be summarized as follows:

Plaintiff, Butler Brothers (herein called "the Company"), is an Illinois corporation, having its principal corporate office at Chicago. It is engaged in the wholesale dry goods and general merchandise business, purchasing from manufacturers and others and selling to retailers only. It operates seven wholesale distributing houses at Chicago,

Jersey City, Baltimore, Minneapolis, St. Louis, Dallas and San Francisco. Each of these houses serves a separate trade territory. At each house stocks of goods are maintained, from which sales are made in its territory. Each house handles its own sales, and all solicitation, credit and [fol. 50] collection arrangements in connection therewith, and keeps books of account showing the operations of the house. All sales in California were made from the San Francisco house and all receipts credited thereto.

Part of the operating expense of the houses is directly and exclusively incurred at the respective houses, including such items as labor, rentals, etc. The remainder consists of certain items of common expense such as executive salaries and corporate overhead and the expense of operating a central buying division and a central advertising division. These expenses are allocated to the respective houses on bases which, it is agreed, are in accord with recognized accounting practice, and the accuracy and propriety of such bases of apportionment are here conceded. For the year 1935 the amount of such allocated expense charged to the San Francisco house was $100,091, of which, it is agreed, approximately seventy-five per cent would have been incurred even though the San Francisco house was not operated. Except for such common expenses, each house is operated independently of each other house.

The company maintains a central buying division through which goods for resale are ordered, but such goods are shipped by the manufacturers to the houses for which ordered, where the cost thereof and the transportation charges thereon are entered on the books of the house. No charges are made against any house for the benefit of the company, or any other house by reason of such centralized purchasing, but the actual cost of operating the central buying division is allocated to the houses, as stated in the preceding paragraph. By reason of the volume of purchases made by the company more favorable prices are obtained than would be obtainable in respect of purchases for the account of any individual house, but addition or reduction in the volume of purchases in an amount equal to the purchases made for the account of the San Francisco house would have no effect on the prices obtainable for the remaining houses.

The company computed its income from the operation of [fol. 51] the San Francisco house by deducting from the

gross receipts from sales of merchandise in California the costs of such merchandise, the direct expenses of the San Francisco house, and the apportioned share of common expenses previously described. According to this computation the San Francisco house operated at a loss of $82,851 for the year 1935. Within the time allowed by law a report showing this loss was made and the minimum tax of $25 was paid for the year 1936. In the year 1935 the operations of all houses of the company produced a profit of $1,149,677. The Franchise Tax Commissioner subsequently assessed an additional tax of $3,798.43, which, with interest amounting to $344.67, was paid under protest on September 16, 1938. The additional assessment was predicated on the allocation to California of 8.1372% of the total income of the company derived from all sources, such percentage having been determined by mathematical average of the percentages which the value of the tangible property, payroll and gross sales attributable to California bore to the corresponding items of all houses of the company. If an allocation is proper, use of the particular percentage here is not questioned.

The tax in question was levied under the provisions of section 10 of the Bank and Corporation Franchise Tax Act (General Laws, Act 8488, Vol. 2, p. 3858; Stats. 1929, p. 19; amended by Stats. 1931, p. 2226; Stats. 1935, p. 965), which, so far as here involved, reads as follows:

"If the entire business of the bank or corporation is done within this State, the tax shall be according to or measured by its entire net income; and if the entire business of such bank or corporation is not done within this State, the tax shall be according to or measured by that portion thereof which is derived from business done within this State. The portion of net income derived from business done within this State, shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacturer, pay roll, value and situs of tangible property, or by reference to these or other factors, or by such other method of allocation as is fairly calculated to assign to the State the portion of net income reasonably attributable to the business done within this State and to avoid subjecting the taxpayer to double taxation."

[fol. 52] It is claimed by appellant that the method by which the tax was fixed and computed was unauthorized

and unlawful, and that such method had the effect of taxing plaintiff on and in respect to income derived from sources beyond the jurisdiction of the state. This resulted, it is contended, in a denial of due process of law and of the equal protection of the law, in violation of the Fourteenth Amendment of the Constitution of the United States.

On the other hand, respondent contends that the tax was levied upon income from business derived from within this state, that the operations of the company are unitary in character, and that the formula for allocation of income used by the Franchise Tax Commissioner was lawful and proper in arriving at the net income of appellant from business done in California—computed to be approximately $95,000.

The sole question to be determined on this appeal is whether it is lawful and proper for the respondent, as Franchise Tax Commissioner, to insist upon use of the formula for allocation of income in a case such as this, or whether the company is entitled to use the separate accounting of its San Francisco house to determine its net income in the State of California. The answer to this question depends entirely on the nature of the business conducted within and without the state by appellant, a foreign corporation. It is only if its business within this state is truly separate and distinct from its business without this state, so that the segregation of income may be made clearly and accurately, that the separate accounting method may properly be used. Where, however, interstate operations are carried on and that portion of the corporation's business done within the state cannot be clearly segregated from that done outside the state, the unit rule of assessment is employed as a device for allocating to the state for taxation its fair share of the taxable values of the taxpayer (Adams Express Co. v. Ohio State Auditor, 165 U. S. 194, 166 U. S. 185, 17 S. Ct. 604; Pullman's Palace Car Com-[fol. 53] pany v. Pennsylvania, 141 U. S. 18, 11 S. Ct. 876; State Railroad Tax Cases, 92 U. S. 575, 23 L. Ed. 663). In the early cases in which the unit rule first made its hesitating appearance there was always a physical link, a palpable unity of substance, a binding together by a system of rails or by telegraph wires. (State Railroad Tax Cases (1875), supra; Western Union Telegraph Co. v. Taggart (1896), 163 U. S. 1, 16 S. Ct, 1054, 41 L. Ed. 49). Then in Adams Express Co. v. Ohio State Auditor (1897), supra,

the standard unity of substance was openly replaced by one of unity of use and management. This decision clearly recognized that in assessing tangible property for taxation, its value producing qualities in connection with other pieces of tangible property outside the state must be considered. If there is any evidence to sustain a finding that the operations of appellant in California during the year 1935 contributed to the net income derived from its entire operations in the United States, then the entire business of appellant is so clearly unitary as to require a fair system of apportionment by the formula method in order to prevent overtaxation to the corporation or undertaxation by the state. (Underwood Typewriter Co. v. Chamberlain, 254 U. S. 113, 41 S. Ct. 45). Such income would be within the purview of the statute quoted above—"The portion of the net income derived from business done within this State".

Preliminary to analysis and discussion of the cases cited by the parties as bearing on the issue involved in the instant case, we shall review briefly the relatively simple factual structure as it is logically reflected in the modus operandi of appellant's business. The company is engaged in buying merchandise from manufacturers and selling to retailers only. It maintains a central buying department outside the state. By its large scale purchasing activity, appellant concededly is able to buy at lower prices than would otherwise be possible, thus realizing a purchasing saving. But it is able to buy in large quantities only because it is able to sell in large quantities, so that it is apparent that the [fol. 54] purchasing saving is made possible only because of the sales. Furthermore, it is pertinent to observe that the saving is not turned into profit until the sales are made. Thus, the purchasing activities and the sales activities are interdependent and supplement one another to form one single, unitary business. Appellant here calls attention to the fact that the parties stipulated that if an amount of sales equal to those of the San Francisco store were eliminated, the volume would not be reduced enough to affect the price at which appellant bought. On this ground appellant urges that the San Francisco store is the one which does not affect purchase price differentials. But, as respondent urges, it also should be noted that it was stipulated that appellant bought at lower prices because of the great volume it obtained through having several stores. The weakness of appellant's argument is readily apparent

when pursued to its logical conclusion. If the omission of the California sales would have no effect on the purchasing power, the omission of sales in an equal amount wherever made would likewise have no effect on the company's ability to purchase at a saving. Thus, by proceeding in turn from state to state, it could be shown that none of the sales in any of the states should be credited with the income resulting from the purchasing of goods in large quantities. It is our opinion that the sales made in each of the seven states in which appellant does business must be proportionately credited with the profits resulting from the purchasing power which such sales in the aggregate produce. Other salient factors indicating the unitary character of appellant's business are the central advertising division and the central accounting and management division. The former enables appellant to spread its advertising cost over more stores and units and to secure its advertising at a lower cost per unit, thereby making possible advertising opportunities unavailable to a single store; as to the latter (central accounting and management department), the vol- [fol. 55] ume of business resulting from operation of the company's several stores permits better as well as more costly services of accounting and management to be available to each store, whereas if each were separately operated, services of such quality in all probability would be too expensive to be practicable.

The Supreme Court of the United States has repeatedly held that companies whose income has resulted from a series of transactions beginning with manufacture in one state and sales in another were unitary businesses. (Underwood Typewriter Co. v. Chamberlain (1920), 254 U. S. 113, 41 S. Ct. 45, 65 L. Ed. 165; Bass, Ratcliff & Gretton, Ltd., v. State Tax Commission (1924), 266 U. S. 271, 45 S. Ct. 82, 69 L. Ed. 282). While it is not clear from the record whether appellant manufactured any of its goods in the State of Illinois or elsewhere, it is conceded that appellant purchased most of its goods through the Illinois central purchasing arrangement. This central purchasing factor is completely analogous and comparable to the manufacturing activities in the Underwood Typewriter and Bass Ale cases, supra, wherein we find recognition of the principle that income from sales is attributable to the series of transactions from which the income is derived. Since these two leading cases involve the validity of allocation by applying

a percentage formula to the entire income in order to determine the income taxable in a state where the business is only partly carried on, we shall consider them in some detail.

In Underwood Typewriter Co. v. Chamberlain, supra, the company manufactured its typewriters in Connecticut and sold them generally throughout the country. Using a statutory method of allocation (by assigning to the state that portion of the total income which the value of real and tangible personal property within the state bore to the total value of such property within and without the state), Connecticut determined that 47 per cent of the company's net income was derived from property and transactions within the state. The company objected to the method of [fol. 56] apportionment on the ground that only a little over 3 per cent of its net receipts was collected in Connecticut. The court upheld the Connecticut allocation for the reasons expressed in the following excerpt from the opinion at pages 120-121:

"• • • The profits of the corporation were largely earned by a series of transactions beginning with manufacture in Connecticut and ending with sale in other States. In this it was typical of a large part of the manufacturing business conducted in the State. The legislature in attempting to put upon this business its fair share of the burden of taxation was faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders. It, therefore, adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State. 'The plaintiff's argument on this branch of the case,' as stated by the Supreme Court of Errors, 'carries the burden of showing that 47 per cent of its net income is not reasonably attributable, for purposes of taxation, to the manufacture of products from the sale of which 80 per cent of its gross earnings was derived after paying manufacturing costs.' The corporation has not even attempted to show this; and for aught that appears the percentage of net profit earned in Connecticut may have been much larger than 47 per cent. There is, consequently, nothing in this record to show that the method of apportionment adopted by the State was inherently arbitrary, or that its application to this corporation produced an unreasonable result."

Here we have clear and concise expression of the only limitation on the use of a formula in the allocation or apportionment of income of a unitary business, to-wit, the formula must not be intrinsically arbitrary, and it must not produce an unreasonable result.

Bass, Ratcliff & Gretton, Ltd., v. State Tax Commission, supra, involved a British corporation engaged in brewing and selling Bass' ale. Its brewing was done and a large part of its sales were made in England, but it had imported a portion of its product into the United States, which it sold in branch offices maintained in New York and Chicago. During the income year in question, the entire business was operated at a substantial profit, but the company, for federal income tax purposes, reported no income for that year from its business within the United States. Presumably this result was reached by computing its income under the sepa- [fol. 57] rate accounting method. The Tax Commission of the State of New York assigned to New York that portion of the total net income which the value of certain specified classes of assets within New York bore to the total value of such assets within and without the state. The company resisted the tax on the ground that it derived no income from New York and that the action of the Commission was an attempt to assign to New York a portion of the company's income derived from business carried on outside the United States. The court, however, upheld the action of the Commission and at page 282 of its opinion expressed its views regarding the allocation of income of unitary businesses as follows:

"So in the present case we are of the opinion that, as the Company carried on the unitary business of manufacturing and selling ale, in which its profits were earned by a series of transactions beginning with the manufacture in England and ending in sales in New York and other places—the process of manufacturing resulting in no profits until it ends in sales—the State was justified in attributing to New York a just proportion of the profits earned by the Company from such unitary business. In Wallace v. Hines, 253 U. S. 66, 69, it was recognized that a State, in imposing an excise tax upon foreign corporations in respect to doing business within the State, may look to the property of such corporations beyond its borders to 'get the true value of the things within it, when they are part of an organic

system of wide extent,' giving the local property a value above that which it would otherwise possess, and may therefore take into account property situated elsewhere when it 'can be seen in some plain and fairly intelligible way that it adds to the value of the (property) and the rights exercised in the State.' This is directly applicable to the carrying on of a unitary business of manufacture and sale partly within and partly without the State."

Thus, it is apparent from the language of this case that with respect to a unitary business, income from the taxing state as determined by an allocation formula was controlling, where the statutory method of apportionment was not shown to be arbitrary or unreasonable.

In support of its argument that respondent's application of the formula would tax income from transactions taking place beyond the jurisdiction of California, appellant relies heavily upon Hans Rees' Sons v. State of North Carolina (1931), 283 U. S. 123, 51 S. Ct. 385, 75 L. Ed. 879. [fol. 58] But an examination of the facts and legal principles involved therein reveals that there is nothing in that decision to support appellant's argument. The corporation was engaged in the business of tanning, manufacturing and selling leather products, and its principal manufacturing and supply house was located in North Carolina. Extensive sales and purchasing activities were carried on outside the state. The corporation offered proof which tended to show that for the years in question the average income having its source within the state was but 17 per cent of the total and actually showing that the percentage of its income attributable to North Carolina did not in any event exceed 21.7 per cent of the total, whereas the statutory formula, restricted to tangible property, had allocated to North Carolina approximately 89 per cent of the income. The opinion clearly recognized the necessity of using a method of apportioning to a state that portion of entire income which is "reasonably attributable to the processes conducted within the borders of that State," but because the particular statutory formula employed, consisting simply of the property factor, attributed to North Carolina a percentage of income "out of all appropriate proportion to the business transacted by the appellant in that State," the court refused to approve the result reached by the formula. Careful analysis of the underlying legal principles considered

in the Hans Rees' case compels us to conclude that it, like the Underwood Typewriter and Bass Ale cases, supra, recognized that where a business is unitary in character, so that its separate parts cannot be fairly considered by themselves and the whole business in the several states derives a value from the unity of use, allocation of income upon a reasonable formula is properly sustained.

The latest expression of the Supreme Court of the United States on this subject brought to our attention is North American Cement Corporation v. Graves (1936), 269 N. Y. 507, 199 N. E. 510; 243 App. Div. 834, 278 N. Y. S. 920; 299 U. S. 517, 57 S. Ct. 311, wherein it is significant to note [fol. 59] that Bass, Ratcliff & Gretton, Ltd., vs. State Tax Commission, supra, was cited in support of its holding that income from the taxing state as determined by an allocation formula was controlling, although the taxpayer showed that by separate accounting much less income would be allocated to the taxing state. The United States Supreme Court and the New York Courts from which the taxpayer appealed all decided the case with memorandum opinions, so the facts must be obtained from the record in the case (Volume 2253, United States Supreme Court Records). The taxpayer, a foreign corporation, owned and operated three cement plants and one lime plant and sold the products thereof. Two of the cement plants were in New York, one was in Maryland and the lime plant was in West Virginia. The corporation operated its four plants separately and sold their products in separate districts, kept separate accounts for them, and sold very little of the output of the West Virginia and Maryland plants in New York. The Tax Commission allocated the net income of the corporation by a one factor formula (property factor) for the income years 1925, 1926, 1927 and 1929. By this means large incomes were allocated to New York for each of those years. The corporation, by an elaborate separate accounting system, showed that for 1925 the New York income was much less than that allocated to that state by the formula, and that for 1926, 1927 and 1929 the corporation sustained large losses from its New York business instead of deriving from New York the income allocated to it by the formula. In the face of this evidence the Supreme Court of the United States, affirming the New York Court of Appeals and Appellate Division, Supreme Court, held that the results of the formula were controlling and upheld the assessment thereon.

The significance of this decision on two points involved in the instant case is readily apparent: (1) it holds that the operations of four separate manufacturing plants, one of them making a different product from different materials [fol. 60] than the others, are so interrelated as properly to be treated as *unitary;* (2) it holds that separate accounting in accordance with recognized accounting practice is insufficient evidence to disprove the propriety and presumption of fairness of formula allocation. On both points this decision is contrary to Standard Oil Co. v. Wisconsin Tax Comm. (1929), 197 Wis. 630, 223 N. W. 85, on which appellant strongly relies in asserting that the results of its separate accounting must be accepted by respondent as tax administrator. However, careful examination of the factual situation in this Wisconsin case reveals a peculiar distinguishing allocation factor which undoubtedly exerted a strong influence on the result reached by the court there.

In Standard Oil Co. v. Wisconsin Tax Comm., supra, the plaintiff company produced, refined, transported and marketed petroleum products in eleven mid-western states, and its property within Wisconsin consisted principally of tanks and filling stations required to supply the Wisconsin demand. Fifty-four per cent of the oil stored in these tank farms was sold to Wisconsin and forty-six per cent without the state. Plaintiff company did practically no manufacturing in Wisconsin. The controversy arose as to the manner in which that part of its income properly taxable in the state of Wisconsin should be ascertained. The Tax Commission used a ratio method provided in the statute for unitary business transactions conducted within and without the state. The company contended that its income should be ascertained by the allocation and separate accounting method by which the Wisconsin business was charged *at the market price* with all products received by it, with the expense of transacting the business, including a proper allocation of general or overhead expenses and office accounting, that there should be credited to Wisconsin the gross amount received from sales of goods within the state, and that the difference constituted the taxable income of plaintiff company. The court upheld the plaintiff company's contentions. [fol. 61] The distinction to be noted here differentiating this Wisconsin situation from the instant case is the fact that the products furnished to the Wisconsin business were charged at "*market value*" rather than at cost. *Market*

value (at wholesale) included reasonable *profit*, and such profit became income to the company in the outside states. This amounted in effect to allocation of income as between Wisconsin and the other states. That the plaintiff company's arbitrary method of assigning a fictitious market value at which the selling division was deemed to have "bought" the oil from the refining division greatly impressed the Wisconsin court and furnished reason for its distinction of the Underwood Typewriter case, supra, appears from the following language at page 639 of the opinion: "Nor do we find anything in Underwood Typewriter Company v. Chamberlain, 254 U. S. 113, 41 S. Ct. 45, inconsistent with our conclusion in this case. There, there was no separation on the basis of market value between the operations of the manufacturing department and the sales department as there is in this case. We perceive no reason why, under the facts in this case, the profits derived from the sales operations should not be ascertained, so far as plaintiff is concerned, as they would be if the sales operations were conducted by a separate corporate entity." Whether the Wisconsin court by its decision placed too much emphasis on the value of fictions is not our concern here; suffice it to say that the Wisconsin court manifestly sanctioned the practice of charging the products to the Wisconsin end of the business at *wholesale market prices* in determining income derived in Wisconsin. The distinction between *market price* and *cost* cannot be ignored; the former includes profits and the latter does not; and it is this differentiation which decidedly limits the applicability of the Wisconsin case to the instant factual situation.

The unitary character of the buying and selling business has been recognized in International Elevator Co. v. Thoresen (1929), 58 N. Dak. 776, 228 N. W. 192, and Great Atlantic & Pacific Tea Co. v. Grosjean (1937), 301 U. S. [fol. 62] 412, 57 S. Ct. 772, 81 L. Ed. 1193. In the Thoresen case, supra, plaintiff company operated a line of grain elevators, about half of which were in Montana and the other half in North Dakota. The company's income was derived chiefly from the sale, outside the state, of grain bought within North Dakota, and the question was whether North Dakota could assess a tax upon any part of the income from the sales outside the state. Like appellant here, the plaintiff company there tried to apportion its income by separate accounting. That procedure was held

improper and allocation of income was sanctioned to North Dakota wholly out of proportion to the receipts within North Dakota. On the mere basis of accounting figures the instant case is less extreme than the North Dakota case, where the net income allocated to the taxing state by the formula exceeded the gross income allocated to the state by separate accounting; yet, in such situation because of the unitary nature of the business, the Supreme Court of North Dakota held that the transactions of buying constituted an essential part of the transactions from which the income collected outside the state was derived.

The Great Atlantic & Pacific Tea Co. case, supra, dealing with a state chain store tax act, bears on the instant issue in that it was there held that the out-of-state stores and central buying and advertising of the buying and selling corporation gave the within-the-state stores advantages which they otherwise would not have had and justified a chain store tax on the within-the-state stores which would otherwise have been, from a constitutional viewpoint, discriminatory. The manifest parallelism between that case and the instant one needs no other comment than the observation that the decision of validity in that case is based on the same reason as that for treating business as unitary in allocating income.

The formula method of allocating or apportioning income in the case of a unitary business was approved by this court in Matson Navigation Co. v. State Board of Equalization, 3 Cal. (2d) 1; affirmed 297 U. S. 728; 56 S. Ct. 553, [fol. 63] 80 L. Ed. 1010. In that case it was established that the power of California to tax foreign corporations measured by their net income and the provisions of section 10 of the Bank and Corporation Franchise Tax Act are co-extensive in scope, and in this connection this court there held that section 10 measures the tax by income from C .fornia and excludes from the measure "income from business done entirely outside the State • • •" (3 Cal. (2d) 1, 8.) In such case as the instant one, allocation of income to the various states in which the business is done by means of a formula that gives weight to the various factors such as property, services of employees and sales, which are responsible for the earning of income, appears entirely reasonable. To rebut the presumption that the formula produced a fair result, "the burden is on the taxpayer to make oppression manifest by clear, cogent evi-

dence." (Norfolk & Western Ry. Co. v. Maxwell (1936), 297 U. S. 682, 688, 56 S. Ct. 625.) In considering the implications of the formula in the last-mentioned case, the Supreme Court of the United States, speaking through Mr. Justice Cardozo, also said at page 688: "* * * a taxpayer does not escape the application of the statute by evidence directed to only one of the related terms. The evidence to be effective must be directed to each of them alike, for only thus can the assumed relation between them be proved to be unreal. * * *" In the case at bar appellant has not furnished any explanation of why its California business differs so from the average that the formula produced an erroneous result. Here there has been only an assertion that a loss incurred in this state. As appellant has failed to show a variance from normal in either the California sales, property or payroll, or in either expenses or revenue, it is our conclusion that appellant has not upheld its burden of proof, for in order to overthrow a formula the taxpayer must introduce such evidence and the [fol. 64] evidence must go to each element of the formula equation. (Norfolk & Western Ry. Co. v. Maxwell, supra.)

In accordance with the foregoing analysis it is our opinion that the unitary nature of appellant's business is definitely established by the presence of the following circumstances: (1) unity of ownership; (2) unity of operation as evidenced by central purchasing, advertising, accounting and management divisions; and (3) unity of use in its centralized executive force and general system of operation. The reasonable and equitable character of this state's formula, based on factors properly reflecting the relative contribution of the activities in the various states to the production of the total unitary income so as not to contravene the restrictions implicit in the Fourteenth Amendment against taxing property outside the state, was recognized in Matson Navigation Co. v. State Board of Equalization, supra. Accordingly, respondent correctly applied the formula method of apportionment to determine California's portion of appellant's income from the business carried on within and without the state.

Judgment affirmed.

Curtis, J.

We concur: Gibson, C. J. Shenk, J., Carter, J.

Traynor, J., took no part in the consideration or decision of this case.

[fols. 65-68] IN SUPREME COURT OF CALIFORNIA. BANK

San Francisco. No. 16157

BUTLER BROTHERS (A Corp.), Appellant,

vs.

CHARLES J. McCOLGAN, as Franchise Tax Commissioner, etc., Respondent

On Appeal from the Superior Court in and for the City and County of San Francisco

JUDGMENT—March 21, 1941

The above entitled cause having been heretofore fully argued, and submitted and taken under advisement, and all and singular the law and premises having been fully considered,

It Is Ordered, Adjudged, and Decreed by the Court that the Judgment of the Superior Court in and for the City and County of San Francisco in the above entitled cause, be and the same is hereby affirmed. Respondent to recover costs on appeal.

Clerk's Certificate to foregoing paper omitted in printing.

[fols. 69-91] IN SUPREME COURT OF CALIFORNIA

[Title omitted]

PETITION FOR REHEARING—Filed April 9, 1941

To the Honorable Phil S. Gibson, Chief Justice, and to the Associate Justices of the Supreme Court of the State of California:

Appellant above named respectfully prays that a rehearing be granted in the above entitled cause.

[fol. 92] The Decision Is Based on Inferences or Presumptions Which It Was Stipulated Should Not Be Made

Finally, at page 15 of the opinion, it is said:

"In the case at bar Appellant has not furnished any explanation of why its California business differs so from

the average that the formula produced an erroneous result. Here there has been only an assertion that a loss incurred in this state,"

[fol. 93] and *Norfolk & Western R. Co. v. Maxwell*, 297 U. S. 682, is cited in support of the proposition that it is incumbent upon a taxpayer questioning a formula to show the inapplicability of all parts thereof. The question here is wholly *distinct from* that in the *Norfolk & Western* case where both income and expense were allocated to the state on a formula basis. The opinion in that case points out:

"For all that appears in the case developed by the Railway, actual gross revenues in North Carolina may have been so far in excess of average gross revenues computed under the statute as to neutralize the discrepancy between actual and average costs of operation. If such a counterbalance exists, appellant has not been injured through the application of the formula."

Here, both income and expense in California are shown by the stipulation. The Company has shown, not "asserted", its income and its expense of the California business, and the facts in this respect are stipulated by the Commissioner, and recognized by this Court in its statement of the case (pp. 2 and 3 of the decision).

It appears that this Court has drawn inferences and presumptions against the Company because of failure to show the reasons why the California income differs from that of other houses. It also appears (pages 6 and 7 of the opinion) that other inferences are drawn regarding the nature and [fol. 94] effect of the advertising and managerial services performed in Illinois for all the houses. We submit that the Court has improperly drawn such inferences, contrary to the stipulation under which this case was submitted (R. 20). It was there agreed that only the stipulated facts were considered by the Commission, and that the Court should indulge no inferences or presumptions as to any matter of fact not set forth in the stipulation. It was further agreed that if notwithstanding this stipulation the Court should deem itself bound to any inferences or presumptions as to matters not covered by the stipulation the matter should be remanded for further hearing.

If any inferences or presumptions are to be indulged by the Court in respect of these matters, we submit that an in-

justice will be done the Company in that such inferences are contrary to facts which, if deemed material, can be shown by the Company, and that if these matters are considered significant the cause should be remanded for further hearing in the trial court. If the cause is so remanded, the Company is prepared and hereby offers to prove:

1. That the San Francisco house was established in 1928;

2. That following such establishment it was necessary to attempt to build up the business in the territory served thereby;

[fol. 95] 3. That the economic depression which had its inception in 1929 occurred before the business was well established and substantially curtailed the business of the house;

4. That such depression continued into the year 1933, and that the volume of business handled by the San Francisco house throughout this period was inadequate to permit operation at a profit;

5. That more or less continuously from 1934 to the present date the Company's operations have been peculiarly harassed by labor difficulties, not only those occurring in the Company's plant, but those which have interrupted and for considerable periods of time wholly suspended water transportation, resulting in increased costs of operation not only in the form of higher wages and transportation charges than were incurred at other houses, but also by reason of labor inefficiency, slowdowns and similar impediments;

6. That as a result of these conditions, costs of operation at the San Francisco house have been substantially in excess of similar costs incurred at many of the other houses of the Company where profitable operations were conducted;

7. That the volume of business transacted through the [fol. 96-99] San Francisco house is much less than in other houses from which a profit is derived, resulting in higher unit costs and less profitable operations;

8. That the so-called advertising of the Company consists solely in the preparation of catalogues and their distribution to retailers with whom the Company does or seeks to do business, and that no advertising advantages other than cer-

tain economies of preparation exist by reason of the presence of seven houses.

* * * * * * *

[fol. 100] IN SUPREME COURT OF CALIFORNIA. IN BANK

[Title omitted]

ORDER DENYING REHEARING—Filed April 17, 1941

By the Court.

Appellant's petition for a rehearing is Denied.

Traynor, J. took no part in the consideration or decision of this matter.

Gibson, Chief Justice.

Dated April 17, 1941.

[File endorsement omitted.]

[fol. 101] [File endorsement omitted]

IN SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1941

[Title omitted]

Petition for Appeal, Assignments of Error and Prayer for Reversal—Filed June 28, 1941

PETITION FOR APPEAL

Considering itself aggrieved by the final decision of the Supreme Court of the State of California in the above entitled cause, the plaintiff in said cause, Butler Brothers, a corporation, hereby prays that an appeal be allowed to the Supreme Court of the United States in said cause, and that an order be made fixing the amount of cost bond thereon:

ASSIGNMENTS OF ERROR

And the said Butler Brothers makes the following assignments of error:

That the Supreme Court of the State of California erred in rendering its said decision, affirming the judgment of

the Superior Court of the State of California in and for [fol. 102] the City and County of San Francisco, the court of first instance in said cause, in each of the respects hereinafter stated:

1. In holding that the California Bank and Corporation Franchise Tax Act, California Statutes of 1929, page 19, as amended, did not deprive Petitioner of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

2. In holding that said Act did not impose a tax on income of Petitioner earned and derived from sources wholly outside of the State of California, thus depriving Petitioner of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

3. In holding that said Act did not deprive Petitioner of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States, although said Act as construed by said Court levied a tax upon a percentage of Petitioner's net income allocated to the State of California by an arbitrary allocation formula (based upon a comparison of Petitioner's property, payroll and sales within California as compared to Petitioner's total payroll, property and sales), in spite of the fact that Petitioner's operations in the State of California were conducted at a loss of $82,851 and Petitioner in fact earned no net income from its operations within the State of California and derived no net income from sources within the State of California.

4. In holding that although in fact Petitioner's operations within the State of California resulted in a loss of [fol. 103] $82,851, it was nevertheless subject to a tax on an assumed net income of more than $90,000 by application of the formula prescribed by said Bank and Corporation Franchise Tax Act as amended, and in holding that said Act in imposing such tax did not deprive appellant of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

5. In holding that Petitioner's business, although it consists only of buying and selling merchandise, is a "unitary"

business; in holding that in the case of a unitary business the Bank and Corporation Franchise Tax Act imposes a tax based on a formula allocation of income regardless of an actual loss incurred on business done in California, and in holding that said Act in so imposing such tax does not deprive appellant of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

6. In deciding this case by indulging in inferences and presumptions contrary to the provisions of paragraph 12 of the stipulation of facts upon which this case was tried.

PRAYER FOR REVERSAL

For which errors the Petitioner, Butler Brothers, prays that the judgment of the Supreme Court of the State of California, dated March 21, 1941, in the above entitled cause be reversed and a judgment be rendered in favor of Petitioner, and that Petitioner be awarded its costs.

Leland K. Neeves, James S. Moore, Jr., Attorneys for Appellant Butler Brothers.

Scott, MacGeish & Falk; Brobeck, Phleger & Harrison, of Counsel.

[fol. 104] [File endorsement omitted]

IN SUPREME COURT OF THE UNITED STATES

October Term, 1941

[Title omitted]

ORDER ALLOWING APPEAL—Filed June 28, 1941

Butler Brothers, the appellant in the above entitled cause, having prayed for an order allowing an appeal in said cause to the Supreme Court of the United States from the judgment made and entered in said cause by the Supreme Court of the State of California on the 21st day of March, 1941, and from each and every part thereof, and having presented its petition for appeal, assignments of error and prayer for reversal, together with its statement as to the jurisdiction of the Supreme Court of the United

States on appeal, pursuant to the statutes and rules of the Supreme Court of the United States in such cases made and provided, and the decision of the Supreme Court of the State of California in said cause having been in favor of the validity of the Bank and Corporation Franchise Tax Act of the State of California under the Constitution of the United States, the validity of said Act having been [fol. 105] drawn in question in said cause upon the ground of its being repugnant to the Constitution of the United States,

It is hereby ordered that an appeal be, and the same hereby is, allowed to the Supreme Court of the United States from the Supreme Court of the State of California in the above entitled cause, as provided by law;

And it is further ordered that the Clerk of the Supreme Court of the State of Calif nia shall prepare and certify a transcript of record, pro edings and judgment in this cause, and transmit the sam to the Clerk of the Supreme Court of the United States;

And it is further ordered that the amount of the cost bond on said appeal herein be, and the same hereby is, fixed in the sum of $500.00.

Dated: June 28, 1941.

Phil S. Gibson, Chief Justice of the Supreme Court of the State of California.

[fols. 106-107] Citation in usual form showing service on Earl Warren, filed June 30, 1941, omitted in printing.

[fols. 108-112] Cost bond on appeal for $500.00 approved and filed June 28, 1941, omitted in printing.

[fol. 113] In Supreme Court of the United States, October Term, 1941

[Title omitted]

Stipulation as to Contents of Transcript of Record—Filed July 7, 1941

It Is Hereby Stipulated that the transcript of record to be filed in the Supreme Court of the United States pur-

suant to the appeal heretofore allowed herein shall include the following:

1. The printed Transcript on Appeal in the Supreme Court of the State of California, including the following documents:

(a) Appellant's complaint.
(b) Respondent's answer to complaint.
(c) Stipulation of Facts filed in the Superior Court of the State of California in and for the City and County of San Francisco.
(d) Findings of Fact and Conclusions of Law of the Superior Court of the State of California, in and for the City and County of San Francisco.
(e) Judgment of the Superior Court of the State of California, in and for the City and County of San Francisco.
(f) Judgment Roll.
[fol. 114] (g) Notice of Appeal.
(h) Stipulation to transcript on appeal.
(i) Clerk's Certificate to transcript on appeal.

2. Order of the Supreme Court of the State of California transferring the cause to the District Court of Appeal of the State of California, Third Appellate District, for hearing and decision.

3. Order substituting Charles J. McColgan, as Franchise Tax Commissioner of the State of California, as defendant in place of Charles G. Johnson, as Treasurer of the State of California.

4. Order of the Supreme Court of the State of California granting a hearing of the cause after hearing and decision by the District Court of Appeal of the State of California, Third Appellate District.

5. Judgment and opinion of the Supreme Court of the State of California, a copy whereof is shown as Exhibit "E" to the statement as to jurisdiction of the Supreme Court of the United States on appeal, document numbered 10 herein.

6. Appellant's petition for rehearing of the judgment of the Supreme Court of the State of California.

7. Order of the Supreme Court of the State of California denying a rehearing.

8. Remittitur of the Supreme Court of the State of California.

9. Petition for appeal, assignments of error and prayer for reversal.

10. Statement as to jurisdiction of the Supreme Court of the United States on appeal.

11. Order allowing appeal.

12. Notice under Rule 12, paragraph 2, Rules of the Supreme Court of the United States and proof of service thereof.

13. Citation and proof of service thereof.

14. Cost Bond.

15. Any opposing statement or motion filed by respondent pursuant to Rule 12(3).

[fol. 115] 16. Stipulation as to contents of praecipe.

Leland K. Neeves, James S. Moore, Jr., Attorneys for Appellant. Earl Warren, Attorney General of the State of California. H. H. Linney, Deputy Attorney General of the State of California. Valentine Brookes, Deputy Attorney General of the State of California; Attorneys for Respondent.

[fol. 115a] [File endorsement omitted.]

[fol. 116] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 117] IN SUPREME COURT OF THE UNITED STATES

STATEMENT OF POINTS TO BE RELIED UPON AND DESIGNATION OF THE PARTS OF THE RECORD TO BE PRINTED—Filed July 21, 1941

Comes now appellant in the above entitled cause and states that the points upon which it intends to rely are:

That the Supreme Court of the State of California e ed in rendering its said decision, affirming the judgment of the Superior Court of the State of California in and for the City and County of San Francisco, the court of first instance in said cause, in each of the respects hereinafter stated:

1. In holding that the California Bank and Corporation Franchise Tax Act, California Statutes of 1929, page 19, as amended, did not deprive Petitioner of its property with-

out due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

2. In holding that said Act did not impose a tax on income of Petitioner earned and derived from sources wholly outside of the State of California, thus depriving Petitioner [fol. 118] of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

3. In holding that said Act did not deprive Petitioner of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States, although said Act as construed by said Court levied a tax upon a percentage of Petitioner's net income allocated to the State of California by an arbitrary allocation formula (based upon a comparison of Petitioner's property, payroll and sales within California as compared to Petitioner's total payroll, property and sales), in spite of the fact that Petitioner's operations in the State of California were conducted at a loss of $82,851 and Petitioner in fact earned no net income from its operations within the State of California and derived no net income from sources within the State of California.

4. In holding that although in fact Petitioner's operations within the State of California resulted in a loss of $82,851, it was nevertheless subject to a tax on an assumed net income of more than $90,000 by application of the formula prescribed by said Bank and Corporation Franchise Tax Act as amended, and in holding that said Act in imposing such tax did not deprive appellant of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

5. In holding that Petitioner's business, although it consists only of buying and selling merchandise, is a "unitary" business; in holding that in the case of a unitary business the Bank and Corporation Franchise Tax Act imposes a tax based on a formula allocation of income regardless of an actual loss incurred on business done in California, and [fol. 119] in holding that said Act in so imposing such tax does not deprive appellant of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States.

6. In deciding this case by indulging in inferences and presumptions contrary to the provisions of paragraph 12 of the stipulation of facts upon which this case was tried.

Appellant represents that the whole of the record, as filed, is deemed necessary to be printed, except the following:

(1) Order of the Supreme Court of the State of California transferring the cause to the District Court of Appeal of the State of California, Third Appellate District, for hearing and decision.

(2) Order of the Supreme Court of the State of California granting a hearing of the cause after hearing and decision by the District Court of Appeal of the State of California, Third Appellate District.

(3) Appellant's petition for rehearing of the judgment of the Supreme Court of the State of California, except that there shall be printed

(a) the following matter appearing on page 1 of the appellant's printed petition for rehearing as filed in the Supreme Court of the State of California (page 39 of the Record certified to the Supreme Court of the United States by the Clerk of the Supreme Court of the State of California):

"To the Honorable Phil S. Gibson, Chief Justice, and to the Associate Justices of the Supreme Court of the State of California:

Appellant above named respectfully prays that a rehearing be granted in the above entitled cause." and

(b) the matter appearing under the subheading "The Decision Is Based On Inferences Or Presumptions Which It Was Stipulated Should Not Be Made" on pages 24 to 28 of appellant's printed petition for rehearing as filed in the Supreme Court of the State of California (pages 62 to 66 of the Record certified to the Supreme Court of the United States by the Clerk of the Supreme Court of the State of California).

[fol. 120] (4) Citation and proof of service.

(5) Cost bond on appeal.

Dated: July 18, 1941.

Leland K. Neeves, James S. Moore, Jr., Attorneys for Appellant.

[fol. 121] Receipt of copy of the foregoing statement and designation is hereby acknowledged, and Respondent hereby waives the right to designate any additional parts of the record to be printed, and consents to the hearing of this cause upon the parts of the record so designated by Appellant.

Earl Warren, Attorney General of the State of California, H. H. Linney, Valentine Brookes, Deputy Attorney General of the State of California, Attorneys for Respondent.

[fol. 122] [File endorsement omitted.]

Endorsed on Cover: File No. 45,611. California Supreme Court. Term. No. 283. Butler Brothers, Appellant, vs. Charles J. McColgan, as Franchise Tax Commissioner of the State of California. Filed July 19, 1941. Term No. 283 O. T., 1941.

(7219)